

Economic and Strategy Review

Monthly Report as at 31 January 2014

The global economy appears to have gathered some momentum.

Economic and Policy Trends: The global economy looks to have gathered some momentum towards the end of last year and leading indicators suggest that this momentum will carry over and build over the year ahead. The latest forecast update from the IMF is consistent with such a profile. After rising an estimated 3% over 2013, world growth is expected to lift to 3.7% in 2014 and 3.9% in 2015. A greater contribution from advanced economies as fiscal drag lessens, remains a feature of the outlook. For 2014, advanced economies are expected to grow by 2.2% after a sluggish estimated gain of 1.3% for 2013. For emerging and developing economies, growth is expected to lift from 4.7% in 2013 to 5.1% for 2014, as their export sectors benefit from strengthening demand in advanced economies.

Central banks in advanced economies are maintaining pro-cyclical policies via conventional and unconventional policy settings. In the US, an improving economic outlook has given the Fed the confidence to begin winding back its asset purchase programme from \$85 billion per month at the end of 2013 to \$65 billion at the start of February. Conventional tightening still looks like a story for 2015 and will need the US unemployment rate to head well below 6.5% to get the Fed engaged. The caveat to this outlook is that the inflation outlook remains well behaved. European and Japanese central banks face less vigorous domestic outlooks and seem prepared to increase policy support if required.

While the Australian economy continued to send mixed signals over the month, the underlying tone was one of improvement. On the stronger side were better than expected outcomes for the trade account, retail sales and business conditions. While building approvals for November eased, the underlying level remained solid. On the weaker side were readings from the labour market, where employment fell 22,600 in December and the unemployment rate remained elevated at 5.8%. The CPI for the December quarter rose by 0.8%, while the underlying rate rose by 0.9%. Even allowing for adverse weather effects and government policy decisions, price gains were elevated and consistent with strengthening demand in some sectors. We continue to hold the view that the Reserve Bank of Australia will hold the cash rate at 2.5% for an extended period and that a modest tightening cycle will begin in early 2015.

Equity Market Trends: Concerns about the prospects for a range of emerging market economies and further Fed tapering unsettled equity markets. In the US the S&P500 fell by 3.6%, while in Japan, the Nikkei declined by 8.5%. Over in Europe, the Euro STOXX 50 ended the month 3.1% lower. Further depreciation in the Australian currency helped cushion falls in the MSCI World ex-Australia Accumulation Index in Australian dollars to 1.2% over the month. In Australia, the S&P/ASX 300 Accumulation Index fell by 3.0% over January

Bond Market Trends: Yields rallied over the month, propelled by weaker labour force data and broader fears of an emerging markets crisis. After rising to 3.04% and 4.38%, three and ten year government bond yields ended the month at 2.84% and 4.00%, respectively. For the month, the UBS Composite Bond Index rose by 1.09%, while the cash sector, as measured by the UBS Bank Bill Index, rose by 0.22%.

Investment Strategy: The recent pull back in the Australian share market has restored some value taking the sector from the upper end of our fair value band back towards the middle. For the time being, we are content for multi sector funds to hold benchmark exposures to the sector but would consider moving modestly overweight if a sufficiently large correction developed.

The modest rally in Australian fixed interest yields has taken the sector towards the top end of our fair value band. Multi sector funds continue to hold benchmark weightings, but we would consider moving modestly underweight if yields rallied significantly lower.

Frank Uhlenbruch, Investment Strategist

Tactical Asset Allocation Summary (as at 31 January 2014)

Asset Class	Multi Sector Trusts*
Australian Shares	Benchmark
Australian Fixed Interest	Benchmark
Cash	Benchmark
International Shares	Benchmark fixed
Australian Listed Property	Benchmark fixed
Global Listed Property	Benchmark fixed

* Multi-sector Trusts may have differing asset class weights, including no exposure to a particular asset class

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